

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:TEGE:EOEG:EO2

PLR-103601-08

Date:

June 25, 2008

In Re:

LEGEND:

Trust =

Trust Agreement =

Trustee =

State =

City =

County =

District =

Board of  
Education =

Dear :

This is in response to a letter dated January 14, 2008, from your authorized representative, requesting a ruling that the income of Trust will be excludable from

gross income under section 115(1) of the Internal Revenue Code ("Code"), and that Trust is not required to file a return with respect to income taxes under the provisions of section 6012(a)(4) of the Code.

## FACTS

District, a political subdivision of City and County in State, seeks to provide health insurance coverage, including medical, hospital, dental, vision, surgical, or other health care benefits, to its eligible retirees. District, the sole employer, established Trust to hold and invest assets designated exclusively for use by District to pay a portion of health insurance premiums of its retirees. District Board of Education will act on behalf of the District for purposes of Trust. All payments made to Trust by or on behalf of District shall lawfully become a part of Trust, together with income, gains, and all other increments to be held, managed, and administered pursuant to Trust Agreement.

Taxpayer represents that under the Plan, all retiree health benefits are fully insured and completely employer-funded. Contributions will not be subject to any election by employee or retiree. Further, no contributions will be made through pre-tax salary reduction agreements. Contributions of the value of paid time-off days and cash-outs are not permitted under the Plan. Nor will eligible retirees receive any amounts in cash or any other taxable or nontaxable benefits in lieu of health benefits.

Taxpayer also represents that Trust assets are used solely to pay a portion of health insurance premiums on behalf of eligible retirees, their spouses, dependents (as defined in § 152 (determined without regard to §152(b)(1), (b)(2), and (d)(1)(B)) and domestic partners who participate in the Plan. Taxpayer further represents that it will take reasonable efforts to identify individuals who do not qualify as a spouse or dependent (under § 152 of the Code) of the retiree who participates in the Plan and will include imputed income relating to the coverage of such individuals in the income of the retiree.

Trustee, designated according to the terms of Trust Agreement, shall carry out its duties, responsibilities, and obligations as outlined therein. Board of Education has the authority to appoint an entity, individual, or group of individuals as Trustee. District may direct Trustee to take any action that District deems prudent with respect to investment of Trust assets, including providing investment guidelines. District may also direct Trustee to make payments from Trust for purposes of providing premium subsidies under Plan, or for administrative expenses of Plan or Trust. District may remove Trustee from office at any time upon 30 days' prior written notice.

Trust's articles of incorporation require that no part of the corpus, income, or any funds contributed to Trust may be used for any purposes other than for the exclusive benefit of retirees, their beneficiaries or dependents. Upon termination of Trust, after

payment of outstanding expenses, remaining assets shall be used for the sole benefit of retirees in such form as permissible under applicable laws and regulations. In no instance will Trust assets be made available to any person or entity that is not an organization whose income is excluded from gross income under §115(1) of the Code.

It is represented that Trust is organized under State law to hold and invest assets for purposes of funding a portion of health care insurance costs of the eligible retirees of District, a political subdivision of City and County in State, that Trust was solely funded by District, and that the beneficiaries of Trust cannot share in the discharge of the Trustee's responsibility for the protection and conservation of property.

## LAW AND ANALYSIS

### Section 115(1)

Section 115(1) of the Code provides that gross income does not include income derived from the exercise of an essential governmental function and accruing to a state or a political subdivision of a state.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from a fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its political subdivisions, is excludable from gross income under section 115. The ruling explains that the investment of positive cash balances by a state or political subdivision thereof in order to receive yield on the funds until needed to meet expenses is a necessary incident of the power of the state or political subdivision to collect taxes or other revenue for use in meeting governmental expenses. In addition, the ruling also provides that because the state and its participating political subdivisions have an unrestricted right to their proportionate share of the investment fund's income, the fund's income accrues to them within the meaning of section 115(1). Rev. Rul. 77-261 points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out those projects desirable from the standpoint of the state government which, on a broad consideration of the question, may be the function of the sovereign to conduct.

Rev. Rul. 90-74, 1990-2 C.B. 34, holds that income of an organization formed, operated and funded by political subdivisions of a state to pool their casualty risks is excluded from gross income under section 115(1). The ruling also holds that income of such an organization formed to pool risks in lieu of purchasing insurance to cover their public liability, workers' compensation, or employees' health obligations is excluded under section 115(1) if private interests do not, except for incidental benefits to employees of the participating state and political subdivisions, participate in or benefit from the organizations.

Trust provides health insurance benefits to eligible retired District employees and their dependents. Providing health insurance benefits to current and former employees constitutes the performance of an essential government function. Based upon Rev. Rul. 90-74 and Rev. Rul. 77-261, Trust performs an essential governmental function within the meaning of §115(1) of the Code.

The income of Trust accrues to the benefit of District and Board of Education, political subdivisions of State. Trust's assets will be used only for administrative expenses and expenditures in providing health insurance benefits to eligible Plan participants. No private interests participate in or benefit from the operation of Trust. Any distribution of remaining funds in Trust to participating employees upon the dissolution of Trust satisfies an obligation District has assumed with respect to providing health benefits to District employees. The benefit to the participating employees is incidental to the public benefit. See Rev. Rul. 90-74.

#### Section 6012(a)(4)

Section 301.7701-1(b) provides that the classification of organizations that are recognized as separate entities is determined under § 301.7701-2, § 301.7701-3, and § 301.7701-4 unless a provision of the Code provides for special treatment of that organization.

Section 301.7701-4(a) provides that , in general, an arrangement will be treated as a trust if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility for profit.

Section 6012(a)(4) provides that every trust having for the taxable year any taxable income or having gross income of \$600 or over, regardless of the amount of taxable income, shall make returns with respect to income taxes under Subtitle A.

#### RULINGS

1. Based on the information and representations submitted, we hold that the income of Trust is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for the purposes of §115(1). Accordingly, Trust's income is excludable from gross income under §115(1) of the Code.
2. The District contributes assets to Trust that are to be used exclusively to pay health care insurance costs of eligible retirees of District. Trustee of Trust is charged with protecting and conserving Trust's assets for beneficiaries who cannot share in the discharge of this responsibility, and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

Assuming Trust is recognized as a separate entity under section § 301.7701, we conclude that Trust is classified as a trust for federal income tax purposes under § 301.7701-4(a).

3. Section 7701(a)(1) and § 301.7701-4(a). Trust is classified as a trust under § 301.7701-4(a). Section 6012(a)(4) does not require Trust to make returns of income when gross income is not \$600 or over. Because Trust's income is excludable from gross income under § 115(1), Trust will not have gross income of \$600 or over, and therefore will not be required file an annual income tax return under § 6012(a)(4).

No opinion is expressed concerning the federal tax consequences of the Trust under any other provision of the Code other than those specifically stated herein. In particular, no representation is made regarding the federal tax consequences of contributions to or payments from the Plan, including (but not limited to) whether contributions to the Plan are excludable from the gross income of employees, former employees or retirees under § 106 and whether payments from the Plan (including reimbursement of medical expenses) are excludable from the gross income of employees, former employees or retirees under §§ 104 or 105.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that this ruling may not be used or cited as precedent.

In accordance with a Power of Attorney on file, we are sending a copy of this letter to your authorized representative.

Sincerely,

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SYLVIA F. HUNT  
Assistant Chief  
Exempt Organizations Branch 2  
Division Counsel/Associate Chief Counsel  
(Tax Exempt and Government Entities)

Enclosures:

Copy of this letter  
Copy for § 6110 purposes